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# OEB Staff Proposal

## Consultation on the Deferral Account – Impacts Arising from the COVID-19 Emergency

**EB-2020-0133**

**December 16, 2020**

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# 1 Executive Summary

On March 17, 2020, the Ontario Government declared a state of emergency in response to the spread of COVID-19. One week later, the OEB established a deferral account (Account) in which electricity and natural gas distributors may record incremental costs as a result of the ongoing COVID-19 emergency, the severity and duration of which was uncertain at that time. In April 2020, the OEB confirmed the applicability of the Account to electricity transmitters and Ontario Power Generation Inc. (OPG). As a result, the Account applies to all rate-regulated entities.<sup>1</sup>

On [May 14, 2020](#), the OEB commenced a consultation (Consultation) on the Account with the goal of establishing guidelines for the operation of the Account. In its letter issued on [July 17, 2020](#), the OEB provided for a preliminary proposal to be prepared by OEB staff (Staff Proposal). The purpose of the Staff Proposal is to provide OEB staff's initial views on the scope of the Account and to facilitate and focus stakeholder comments. The Staff Proposal strives to strike a balance between utility and ratepayer interests while having regard to the nature of the COVID-19 pandemic, as well as the assessments provided by London Economics International LLC (LEI).

## 1.1 Introduction to OEB Staff's Positions

The COVID-19 pandemic has raised unprecedented challenges for energy regulation. Whether such a crisis calls for modifications to the established rate-making regime in Ontario was at the heart of OEB staff's thinking in terms of the scope and operation of the Account. OEB staff considered the best approach to establishing an effective and efficient framework that could also provide certainty to stakeholders on a timely basis.

The COVID-19 pandemic has had widespread economic and societal impacts. In its *COVID-19 Impact Study*, LEI observed that "although utilities have seen negative revenue and cost pressures as a result of the pandemic, the observed financial impact has so far been controlled."<sup>2</sup> Based on publicly available information, these negative cost and revenue impacts have not translated into acute financial issues for utilities thus

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<sup>1</sup> Rate-regulated electricity distributors, transmitters, and OPG, as well as natural gas distributors are collectively referred to as utilities in this document. <sup>2</sup> LEI, *COVID-19 Impact Study*, December 15, 2020, page 1

<sup>2</sup> LEI, *COVID-19 Impact Study*, December 15, 2020, page 1

far, and data available to date suggests the sector, as a whole, has maintained its financial integrity.<sup>3</sup>

In its *Report on Regulatory Principles, Policies and Accounting Treatments Applied in Other Jurisdictions in Response to COVID-19*, LEI observed that only 39% of regulators surveyed have responded to the pandemic with the establishment of generic deferral accounts, while another 31% have either taken no definitive action or are currently underway in proceedings to determine cost recovery.<sup>4</sup> A number of jurisdictions have also chosen to hear requests for deferral accounts on a case by case basis. Most regulators studied articulated traditional regulatory principles to be relied upon when considering cost recovery, such as just and reasonable rates and prudence. But they also articulated qualifiers such as appropriate, extraordinary, and necessary.<sup>5</sup>

In its *COVID-19 Impact Study*, LEI also observed that liquidity risks for smaller distributors could emerge in the event that bad debt levels increase substantially going forward.<sup>6</sup> In the longer term, more permanent demand pattern changes may emerge through increased residential consumption and decreased commercial consumption. As government stimulus programs wind down, negative longer-term demand impacts and more pronounced impacts to utility financial health may emerge.

The impacts observed in 2020 was the lens through which OEB staff focused its Staff Proposal. Utilities in Ontario have responded admirably to the pandemic. They have operated continuously, as they provide an essential service in producing and delivering energy to residences and businesses. The approach outlined in the Staff Proposal is partly based on the fact that most utilities have been able to withstand any severe financial impacts, but is also a reflection of how well utilities have been able to manage their affairs as they have transitioned (and continue to transition) to their new operating “normal”. The approach is also reflective of the need to mitigate, to the extent possible, impacts on customers.

OEB staff anticipates that the Account will remain in operation for each rate-regulated utility up to the effective date of a utility’s next cost-based rate order, provided that at

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<sup>3</sup> LEI, *COVID-19 Impact Study*, December 15, 2020, page 7

<sup>4</sup> LEI, *A Report on Regulatory Principles, Policies and Accounting Treatments Applied in Other Jurisdictions in Response to COVID-19*, December 15, 2020, page 4

<sup>5</sup> LEI, *A Report on Regulatory Principles, Policies and Accounting Treatments Applied in Other Jurisdictions in Response to COVID-19*, December 15, 2020, page 5 & 24. For example, the Oklahoma Corporation Commission found that “it will consider in future proceedings whether each utility’s request for recovery of these regulatory assets is reasonable and necessary”.

<sup>6</sup> LEI, *COVID-19 Impact Study*, December 15, 2020, page 1

that time, a utility can be reasonably expected to incorporate any permanent effects of the pandemic into its forecasts. At that time, it is OEB staff's expectation that any utility-specific impacts arising from the pandemic will have been addressed from a rate-making perspective, on a go forward basis. The Account is by its very nature a retrospective review. This means that any relief sought by utilities that qualify will be realized, at a minimum, 12-18 months after a utility began experiencing impacts and recorded them in the Account. As noted previously by the OEB, any individual utility that anticipates financial or operational viability issues in the near term should contact the OEB immediately to discuss their specific circumstances.<sup>7</sup>

This Staff Proposal does not address the manner in which any amounts in the Account should be recognized for financial statement purposes. As noted in the August 14, 2020 Issues List letter, the OEB does not have to explicitly involve itself in supporting utilities in achieving a desired financial accounting result. OEB staff notes that the key objective of the OEB's final guidance to be issued is to assist the OEB in making its decision on the recoverability of the amounts in the Account, not to provide any direct assurance of recoverability in relation to utilities' external financial reporting.

## **1.2 Summary of Key Positions**

OEB staff is of the view that utilities must demonstrate a financial need for recovery of amounts in the Account, subject to certain exceptions described below. OEB staff suggests that a means test based on the lower end of the OEB's dead band of approved ROE ensures that utilities who make recovery claims are doing so to ameliorate the fact that their earnings have been reduced below the point of reasonably expected fluctuations, as opposed to restoration of their full profitability margins.

For utilities that pass the means test, OEB staff recommends that any material and prudently incurred incremental impacts, directly attributable to the pandemic, should be eligible for recovery at a rate of 50%. This net-cost sharing approach recognizes:

- The need to preserve the financial incentives to mitigate costs and maximize savings attributable to the pandemic, a principle consistent with incentive rate-making
- The fact that ratepayers are experiencing economic hardship from the same events that are driving the incremental impacts to utilities, which is not typically the case with traditional Z-factor events

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<sup>7</sup> EB-2020-0133, OEB Letter, September 24, 2020, page 3

- The striking of a balance between two potentially opposite positions expected to be taken by utilities and other stakeholders – i.e. the balance between full recovery and full disallowance
- The need for regulation to serve as a proxy for competition. In the competitive environment, many businesses have incurred, and continue to incur, losses attributable to the pandemic. A recovery mechanism that fully insulates utilities from the pandemic's negative impacts would be misaligned with the regulator's role to mimic competitive forces

OEB staff recommends that incremental impacts (both increases and decreases in costs and revenues) directly attributable to the pandemic should be recorded in the Account. However, OEB staff also takes the position that utilities should not be required to automatically return any net gains in the Account, in the event that savings exceed costs, as the Account was established to facilitate any claims for relief by utilities at a time when the impacts of the pandemic were unknown.

OEB staff is of the view that the parameters of this Account should be established in a manner that, where possible, maximizes regulatory efficiency. In that regard, OEB staff recommends that only those utilities that have intentions of submitting a claim for recovery (with due consideration to the applicability of the proposed means test) should be required to continue to track the impacts associated with this Account, in order to support their future disposition requests.

OEB staff recommends two exceptions to its proposed approach:

- 100% of any prudently incurred and material costs (or lost revenues) necessary to comply with government or OEB actions taken to assist ratepayers should be recoverable in full and the means test applicable to those amounts should be the upper end of the OEB's dead band of approved ROE (as opposed to the lower end proposed for the other amounts)
- For the other amounts, in circumstances where utilities can demonstrate that, after passing the proposed means test, their financial viability would be compromised if their pandemic-related recoveries are limited to 50% of the incremental impacts, the OEB should consider recoveries at a rate of greater than 50% on a case-by-case basis

## 2 Consultation Background

### 2.1 Process to Date

Following the Government of Ontario's declaration of a state of emergency on March 17, 2020,<sup>8</sup> the OEB established the Account through an Accounting Order issued on [March 25, 2020](#). The OEB established the Account for electricity and natural gas distributors to record the impacts arising from the COVID-19 emergency. The OEB confirmed the applicability of the Account to electricity transmitters and OPG through an Accounting Order issued on [April 29, 2020](#).

The OEB allowed utilities to track these impacts in the Account, with the nature, degree, and mechanism of any cost recoverability to be determined by the OEB in due course.

On [May 14, 2020](#), the OEB commenced the Consultation. The OEB also invited comments on a draft issues list (Draft Issues List). The Consultation is intended to address how the Account will operate, including the nature and degree of costs and lost revenues (net of offsetting savings) eligible for recovery, as well as the associated recovery mechanism.

A preliminary stakeholder meeting was held on May 28, 2020 to discuss the issues on the Draft Issues List. Written and reply comments were submitted by stakeholders, in response to the OEB's follow-up letter issued on [June 4, 2020](#). In its letter issued on [July 17, 2020](#), the OEB provided for a Staff Proposal.

On [August 6, 2020](#) the OEB issued an Accounting Order, establishing the Forgone Revenues from Postponing Rate Implementation sub-account to allow for discrete tracking of those amounts, while acknowledging that the disposition of these impacts was mechanistic in nature. On [August 14, 2020](#), the OEB issued an Accounting Order, establishing the Bad Debt sub-account.

On [August 14, 2020](#), the OEB approved an issues list (Final Issues List).

On [September 24, 2020](#), the OEB announced that, in support of its integrated Utility Remuneration and Responding to Distributed Energy Resources (DERs) consultations,<sup>9</sup>

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<sup>8</sup> The Government of Ontario's declaration was made under the *Emergency Management and Civil Protection Act* to help fight the spread of COVID-19

<sup>9</sup> EB-2018-0287 and EB-2018-0288

LEI was commissioned to prepare a *COVID-19 Impact Study* to assess the near- and long-term impacts of the pandemic on Ontario's energy sector and identify implications for the OEB's regulatory policy response to energy sector evolution. The OEB stated that the results of LEI's *COVID-19 Impact Study* are expected to be informative in both of those consultations, as well as in this Consultation. In addition, the OEB explained that it further commissioned LEI to provide the following:

- A Report on Gains and Losses from Differences in Load<sup>10</sup> and Production
- A Report on Regulatory Principles, Policies and Accounting Treatments Applied in Other Jurisdictions in Response to COVID-19<sup>11</sup>
- A Report on the OEB's Cost of Capital Parameters and the Impacts of COVID-19

The above reports, as well as the *COVID-19 Impact Study*, are being posted contemporaneously with this Staff Proposal. Each one of LEI's deliverables has informed, to some degree, the Staff Proposal and is further anticipated to be informative to participating stakeholders in this Consultation as independent research.

## **2.2 Purpose of the Staff Proposal**

The intent of this Staff Proposal is not to pre-determine the outcome of the issues that are subject to the Consultation. Rather, this Staff Proposal reflects OEB staff's view of what the OEB's regulatory guidance should be with respect to the nature, purpose, and operation of the Account. It is generally intended to be a starting point for rules surrounding the Account, with justification, but is also intended to elicit stakeholder comments and perspectives.

Final guidance is anticipated to be issued by the OEB to assist utilities in assessing the need for, and if necessary, properly submitting applications for review and disposition of the Account balance in due course.

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<sup>10</sup> In LEI's report, and throughout this Staff Proposal, load generally refers to consumption, demand, and volumes.

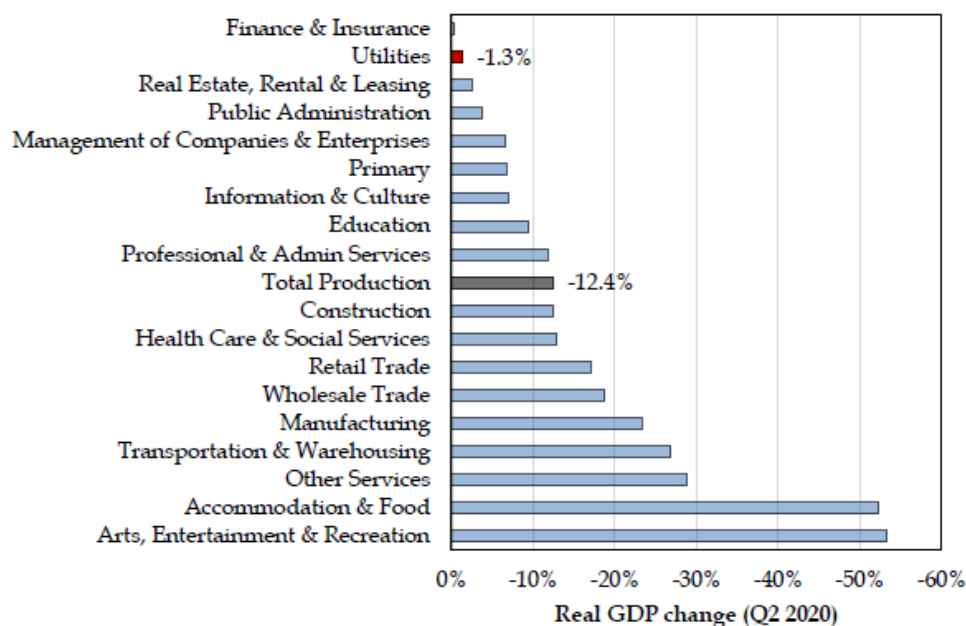
<sup>11</sup> This report will also be used in the Utility Remuneration and Responding to DERs consultations (EB-2018-0287 and EB-2018-0288).



### 3 Overview of the Pandemic's Impact on the Sector

The pandemic is a once-in-a-century crisis that has inflicted far-reaching economic and societal impacts across Ontario and globally. Regarding the impact of the pandemic on the sector, OEB staff notes that utilities, as providers of essential services, seemed to have fared better financially relative to other businesses. For example, LEI noted in its *COVID-19 Impact Study* that Ontario's seasonally adjusted real gross domestic product (GDP) change by industry for Q2-2020 show that the declines for the utilities sector were less significant relative to all other industries (with the exception of "finance and insurance"), at 1.3%, as compared to the decline in total production (i.e. output across all industries) of 12.4%. A table showing these GDP changes has been reproduced from the *COVID-19 Impact Study* below. This industry assessment illustrates that, at a time when the impact of the pandemic resulted in the largest quarterly GDP decline on record, the impact in the utilities industry was not particularly severe.<sup>12</sup>

**Figure 10. Real GDP change by industry for Q2-2020**



Source: Ontario Ministry of Finance. [Ontario Economic Accounts Tables, Table 15 - Ontario Production by Industry at 2007 Prices, seasonally adjusted data at annual rates, millions of chained \(2012\) dollars.](#)

<sup>12</sup> LEI, *COVID-19 Impact Study*, December 15, 2020, page 19

LEI has also prepared an independent report on the impacts of the pandemic on the OEB's cost of capital parameters. LEI's findings suggest that utilities in Ontario appear to be fairly compensated for their risks based on current parameters.<sup>13</sup>

OEB staff has been collecting data from electricity distributors on a monthly basis with respect to their cash flow and observes that they have generally managed well during the pandemic to date. OEB staff notes that there does not appear to be any immediate liquidity issues for the electricity distributors at this time.

OEB staff has also been collecting monthly data on the balances reported by utilities in the Account. To date, the bad debt and lost revenues sub-accounts represent a substantial portion of the total balances reported.

Through its ongoing monitoring of the impacts of the pandemic on the utility sector, OEB staff's expectation is that Ontario's utilities are likely experiencing, to some degree, the following incremental impacts attributable to the pandemic:

- Bad debt expenses
- Revenue losses and gains from changes in load or production
- Support for remote work capabilities
- Costs for personal protective equipment, enhanced sanitation, and compliance with physical distancing and quarantining protocols
- Financing costs (and savings) from changes in cash flows (and borrowing rates)
- Savings related to corporate events, travel, meals, and accommodation
- Costs (and savings) associated with the reprioritization of capital programs
- Costs (and savings) associated with the reprioritization of maintenance programs
- Costs from complying with government and OEB actions to support ratepayers

While the above list is not exhaustive, it is intended to provide a general indication of the utility impacts that OEB staff has largely considered in the development of this Staff Proposal.

To support this Consultation, LEI prepared a *Report on Regulatory Principles, Policies and Accounting Treatments Applied in Other Jurisdictions in Response to COVID-19*. LEI observed that each one of the 59 surveyed states in the USA and provinces in Canada had mandatory or voluntary disconnection moratoriums in place at some point

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<sup>13</sup> LEI, *A Report on the OEB's Cost of Capital Parameters and the Impacts of COVID-19*, December 15, 2020, page 10

in 2020, most of which have since expired.<sup>14</sup> LEI also observed that there have been relief programs instituted for customers, such as payment arrangements and government-funded relief.

OEB staff observes that this indicates that the general climate and conditions that utilities in other jurisdictions have been operating under during the pandemic appear to be generally comparable to that in Ontario. Yet, there have been a wide range of responses by regulators with respect to cost recoveries. Regarding the deferral of COVID-19-related costs in other jurisdictions, LEI noted that in 23 (39%) of the surveyed jurisdictions, generic deferral accounts for utilities were authorized (with six of those establishing them where “deferral authorization is for accounting purposes only and does not bind the Commission to any particular course of action in any future proceeding before the Commission”). In 18 (31%) of the jurisdictions, an account was established on a utility-specific basis. In addition, eight others have taken no definitive action. Another 10 jurisdictions had proceedings for cost provisions that were still pending.<sup>15</sup>

OEB staff observes, however, that there has been one area (lost revenue from lost load) where there appears to be consistency among regulators. LEI noted that eligibility of lost revenues for deferral has been contentious across the surveyed jurisdictions that established generic accounts, with only 35% allowing the deferral of lost revenues from waived fees, followed by 17% for lost revenues from expanded payment arrangements, and only one jurisdiction (California) for lost revenues from lost load.<sup>16</sup>

Utility customers have also been adversely affected by the pandemic. Many commercial and industrial customers have been either shuttered or forced to comply with various government-mandated protocols. Residential customers who are employed by those businesses have also been significantly impacted by government restrictions, and in many cases have lost their employment. LEI noted in its COVID-19 Impact Study that in May 2020, following the peak of the lockdown measures, Ontario’s unemployment rate rose to 10.8%, compared to 5.3% before the pandemic.<sup>17</sup>

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<sup>14</sup> LEI, *Report on Regulatory Principles, Policies and Accounting Treatments Applied in Other Jurisdictions in Response to COVID-19*, December 15, 2020, page 1

<sup>15</sup> LEI, *Report on Regulatory Principles, Policies and Accounting Treatments Applied in Other Jurisdictions in Response to COVID-19*, December 15, 2020, page 4, Figure 1 and pages 20-21, Figure 7

<sup>16</sup> LEI, *Report on Regulatory Principles, Policies and Accounting Treatments Applied in Other Jurisdictions in Response to COVID-19*, December 15, 2020, page 5 & 6. LEI stated that these percentages account only for the jurisdictions that have explicitly allowed for these components to be deferred; orders issued by many regulators lack specificity as to the type of expenses and revenues allowed, and so their view on deferring lost revenues cannot be inferred.

<sup>17</sup> LEI, *COVID-19 Impact Study*, December 15, 2020, page 59

## 4 Approach to Staff Proposed Positions

### 4.1 Overall Approach

The intent of this Staff Proposal is to set out an approach that is unique to the pandemic, articulating a fair balance between utility and ratepayer interests, with due consideration to:

- a) The nature of the pandemic's impacts on utilities, and to what degree those impacts should be recorded in the Account. In OEB staff's view, those impacts can be generally divided as:
  - **Utility operations impacts** – including adhering to government-mandated rules, physical distancing, and enhanced health protocols for employees and customers that are necessary to maintain reliable utility services
  - **Customer-driven impacts** – including changes in consumption patterns and closures of various businesses (e.g. loss or gain in revenues associated with load), and increases in customer account defaults arising from financial hardship (e.g. bad debt)
- b) Whether a means test should be applied and, if so, what is the most appropriate means test for utilities to demonstrate that they require recovery of any of the above impacts from their respective customers.
- c) The nature of the Account, which was established in order to enable utilities to claim their incremental impacts resulting from the pandemic. OEB staff has not approached the Account from the lens that it requires utilities to return any net gains, in the event that savings exceed costs.
- d) Predictability in Account guidance, insofar as its rules and requirements are applied consistently in similar circumstances, as well as being adaptable, flexible, sustainable, and practical to administer, in terms of cost and complexity.

### 4.2 OEB's Role and Principles

The OEB is mandated to set just and reasonable rates for the electricity and natural gas sectors. In accordance with the *Ontario Energy Board Act, 1998*, in carrying out its responsibilities, the OEB is guided by the objectives of protecting the interests of

consumers with respect to prices, the maintenance of financially viable electricity and natural gas industries, as well as other objectives. That balancing of legislative objectives must be done in the context of the global pandemic.

OEB staff recommends that the recovery of the Account balance requires each of:

- A preservation of the financial incentives inherent in, and consistent with, the OEB's general incentive ratemaking framework
- A recognition of the fact that both customers and utilities are adversely impacted from the same events
- A need to demonstrate that earnings are beyond the range of reasonably expected fluctuations for a regulated utility

OEB staff recommends that existing and well-established regulatory principles should guide the scope and operation of the Account, including the recovery of any balance in the Account, and on what basis.<sup>18</sup> Overarching principles such as appropriate allocation of risk, minimization of intergenerational inequity, and transparency have all informed OEB staff's approach. OEB staff has also included the principle of "necessity" for stakeholder consideration.

The principle of necessity, which underpins the Staff Proposal, can be described as follows:

- Recovery of any balances recorded in the Account should be subject to evidence that the costs are not only reasonable, but also necessary to the maintenance of the utility's financial viability.

### **4.3 Examination of Existing OEB Policy**

#### **4.3.1 Z-factor**

A Z-factor is a cost recovery mechanism established to address incremental costs arising from events that are not within management's control and outside the basis upon which rates are derived. A utility is expected to supply details of management's plans for

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<sup>18</sup> General regulatory principles have similarly been referred to in EB-2015-0040 *Report of the Ontario Energy Board, Regulatory Treatment of Pension and Other Post-employment Benefits (OPEBs) Costs*, dated September 14, 2017, page 3.

addressing these events in support of its request for special cost recovery. OEB staff believes there are some aspects of the Z-factor that should apply to this Account.<sup>19</sup>

OEB staff is of the view that one of the primary differences between a typical Z-factor event and the pandemic is the impact on customers. A storm, for example, results in temporary physical damage to the system and cost expenditures for restoration. However, consumers do not typically experience significant economic hardship from an event that has temporarily damaged the utility's system. That is not the case for the pandemic, where the event that is leading to incremental utility costs and/or lost revenues is simultaneously taking an economic toll on ratepayers.

Furthermore, the pandemic is expected to be a long-term and continuing event, rather than an acute weather-related impact typical in Z-factor applications. This warrants consideration of whether utility incentives can be preserved through a net cost-sharing mechanism.

Due to the unique nature of the event, the economic impacts on all customers, and the expectation of continuing impacts, OEB staff recommends that the pandemic should not be considered directly comparable with other unforeseeable events, such as Z-factor events.

#### **4.3.2 Means Tests – ACM/ICM, Inflationary Increases, Off-Ramps**

Under the OEB's ratemaking framework, the advanced capital module (ACM) and the closely related incremental capital module (ICM) are mechanisms by which a distributor (or other utilities as applicable) can apply for and receive funding for significant capital projects that are undertaken in years between cost of service applications. They are exceptions to the general rule – integral to the concept of incentive regulation, which largely decouples rates from costs – that a utility must manage its business within its approved rates until its next rebasing. The ACM and ICM are intended to address the treatment of capital investment needs that arise during the rate-setting plan which are incremental to a materiality threshold. The materiality threshold represents a distributor's financial capacities underpinned by existing rates, including growth.

To access ACM and ICM funding, the applicant must pass a means test. If a utility's regulated return exceeds 300 bps above the approved ROE embedded in the utility's

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<sup>19</sup> The Z-factor eligibility criteria are set out in the *Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors*, Appendix: Filing Guidelines, Table 8, page V, July 14, 2008

rates, that utility does not qualify for funding for an incremental capital project.<sup>20</sup> Exceeding the 300 bps dead band is an indication that funding in advance of the next rebasing is likely not required from a cash flow perspective.<sup>21</sup>

The application of the upper boundary of the OEB's dead band (achieved ROE >300 bps over approved) is a sign of over-earnings when assessing the need for an increase. While the ACM/ICM means test is applied for a different purpose, it is, in OEB staff's view, an indication that the utility's earnings have exceeded the range of fluctuations that can be reasonably expected year over year.

The OEB also applies a means test for inflationary increases. A utility earning in excess of the dead band is expected to either refrain from seeking an adjustment to its base rates through a Price Cap Incentive Rate-setting (IR) or Annual IR Index plan, or provide justification for why an inflationary increase is warranted despite over-earnings.<sup>22</sup>

The OEB also uses a similar assessment for its annual monitoring of utility performance with respect to off-ramps.<sup>23</sup> A regulatory review by the OEB may be triggered if a distributor's earnings fall outside of a dead band of +/- 300 bps from the OEB-approved ROE.<sup>24</sup> This review is performed to assess whether a utility's costs and its revenue stream require realignment, for the sake of maintaining financial viability and/or reasonable rates. In OEB staff's view, the lower end of this dead band is an important indicator for putting the necessity principle into quantifiable terms.

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<sup>20</sup> *Filing Requirements For Electricity Distribution Rate Applications – 2020 Edition for 2021 Rate Applications - Chapter 3 Incentive Rate-Setting Applications*, May 14, 2020, Section 3.3.1 Advanced Capital Module (page 25); Section 3.3.2 Incremental Capital Module (page 26)

<sup>21</sup> EB-2014-0219, *Report of the Board New Policy Options for the Funding of Capital Investments: The Advanced Capital Module*, September 18, 2014, page 16

<sup>22</sup> *Filing Requirements For Electricity Distribution Rate Applications – 2020 Edition for 2021 Rate Applications - Chapter 3 Incentive Rate-Setting Applications*, May 14, 2020, Section 3.3.5 Off-ramps (page 33)

<sup>23</sup> An off-ramp is based on a pre-defined set of conditions under which a rate plan would be terminated or modified before its normal end-of-term date, as defined in the *Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors*, July 14, 2008, page 37.

<sup>24</sup> *Filing Requirements For Electricity Distribution Rate Applications – 2020 Edition for 2021 Rate Applications - Chapter 3 Incentive Rate-Setting Applications*, May 14, 2020, Section 3.3.5 Off-ramps (page 33); *Report of the Board, Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach*, October 18, 2012, page 11, states that "The Board's policy in relation to the off-ramp, as set out in its July 14, 2008 EB-2007-0673 *Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors*, continues to be appropriate. Each rate-setting method will include a trigger mechanism with an annual return on equity ('ROE') dead band of  $\pm 300$  basis points."

## 5 Staff Proposed Positions

### 5.1 Criteria for Recording Amounts

#### 5.1.1 Approach

OEB staff has considered the following two approaches in articulating what types of impacts may be recorded in the Account for utilities that expect to meet the means test:

- A prescriptive approach that specifies what kinds of incremental impacts may be recorded (particularly regarding utility operations)
- A flexible approach that allows the utility to record what it has deemed to be a discrete, incremental impact and directly attributable to the pandemic

OEB staff recognizes that being prescriptive with respect to the nature of eligible impacts has its benefits, in that all parties will have more certainty and predictability when it comes to the amounts that are subsequently brought forth for disposition. However, given the diversity in size, operations, and customer bases in Ontario's utility landscape, OEB staff also believes that narrowing the list of impacts at this time may be too restrictive and may lead to overlooking the unique impacts being experienced by different utilities. For those reasons, OEB staff's view is that at this time, it is appropriate for the OEB to allow for flexibility, providing utilities the latitude to record what they assess as incremental and attributable to the pandemic, given their own circumstances.

OEB staff recommends that the long-standing regulatory concepts for deferral and variance accounts (DVAs) of causation, prudence and materiality should apply to the amounts recorded in the Account. As such, any material and prudently incurred incremental impacts, directly attributable to the pandemic, should be eligible for recording in the Account. Although not an exhaustive list, nor an indication of any advanced policy direction in any form, utilities may refer to the impacts identified by OEB staff in section 3, "Overview of the Pandemic's Impact on the Sector", in considering what types of impacts, directly attributable to the pandemic, may be recorded.



## 5.1.2 Causation, Prudence, and Materiality Criteria

### *Causation*

Utilities could not have been expected to have foreseen a pandemic of this magnitude. The pandemic can be viewed as a significant, extraordinary event for a duration not yet known. In relation to causality, a general criterion of an incurred cost is that it was beyond the ability of management to control and the pandemic certainly meets this criterion.

OEB staff recommends that the criteria for which amounts are eligible for recording in the Account should not be based on the nature of the impacts, but on the drivers.<sup>25</sup> OEB staff suggests that the impacts recorded must be determined to have only been incurred as a result of the pandemic. A utility should demonstrate that when it records amounts in the Account, an appropriate baseline and incremental impact measurement can be established.

In OEB staff's opinion, this should provide sufficient guidance as to what should be recorded, or not recorded, in the Account, without being too prescriptive regarding required rules of the Account. It is not necessary to limit the nature of costs at this stage. That said, there are certain costs that warrant further discussion, based on the fact that precedent cases exist with respect to the OEB's approach to recovery of these impacts. Those costs include lost revenues associated with load, and bad debt, which are discussed further in this Staff Proposal.

### *Prudence*

OEB staff recommends that final amounts should be recorded in the Account when the utility can demonstrate that it has acted prudently to minimize those impacts and has fully exploited all available cost-reductions and savings, including those that have become available in light of the pandemic.

Although utilities could not have been expected to foresee the pandemic, the extent to which they had emergency preparedness plans to deal with a wide range of emergencies can and should be used as one criterion in assessing prudence. OEB staff therefore recommends that the demonstration of well-executed disaster recovery plans,

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<sup>25</sup> For example, the nature of the costs may be laptops or other IT infrastructure already incurred on a regular basis, but the increased level of spending could be tied to pandemic-related matters, warranting its inclusion.

appropriate planning processes, and pivots in business plans appropriately carried out is a key aspect of demonstrating prudence. Utilities should also quantify any savings that result from its mitigation actions taken, and include those offsetting impacts in the Account.

### **Materiality**

OEB staff recommends that the amounts recorded in the Account should have a material impact on the utility's operations based on the established materiality thresholds. The materiality thresholds for the Account should correspond to those articulated in the filing requirements for cost of service applications for each type of utility (i.e., electricity distributor, electricity transmitter, and natural gas distributor).<sup>26</sup> The materiality threshold for OPG should be as set out in the last OPG payment amounts decision.<sup>27</sup>

A key issue for this Consultation is to what extent should the OEB establish a net cost-sharing model between the utilities' ratepayers and shareholders regarding the recovery of the Account. One alternative approach would be to raise the materiality thresholds. However, OEB staff takes the view that, given the proposed application of a means test and 50% recovery rate, the standard approach to materiality should apply, rather than considering a more expansive (or a raising of the) threshold in the context of the pandemic.

OEB staff recommends that the materiality threshold should be applied to the total amount recorded in the Account (i.e., overall Account basis versus on an individual sub-account basis), inclusive of any savings (i.e., net total incremental costs that are offset by any savings). OEB staff's view is that the pandemic impacts must be assessed on the whole of the entity's business, and with many offsetting or overlapping impacts, it is more insightful to assess materiality at the control account level.

OEB staff is of the view that there should be one exception to this rule. The costs associated with complying with government or OEB actions designed to assist ratepayers should be assessed separate from the other costs in the Account, given the discrete drivers for these costs explained further below.

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<sup>26</sup> *Filing Requirements For Electricity Distribution Rate Applications - 2020 Edition for 2021 Rate Applications - Chapter 2 Cost of Service*, May 14, 2020, page 5; *Filing Requirements For Electricity Transmission Applications Chapter 2 Revenue Requirement Applications*, February 11, 2016, page 6; *Filing Requirements For Natural Gas Rate Applications*, February 16, 2017, page 38

<sup>27</sup> EB-2016-0152, Ontario Power Generation Inc., Decision and Order, December 28, 2017, page 142

### **5.1.3 Costs, Savings, and Netting Treatment**

OEB staff is of the view that incremental amounts (both increases and decreases in costs and revenues) should be recorded in the Account where a utility makes a claim to recover amounts from ratepayers. As noted elsewhere in the Staff Proposal, OEB staff has not approached the Account from the perspective that it requires utilities to return any net gains, in the event that savings exceed costs. In OEB staff's view, this Account was not established as an industry-wide variance for all pandemic-related impacts, but as a mechanism for utilities to track those impacts in the event that they qualify for relief.

### **5.2 Measuring Incremental Impacts**

To define incrementality, OEB staff recommends that, for each discretely identifiable cost driver, the amounts recorded in the Account should be calculated using a baseline comparison to the greater of:

1. The amount embedded in base rates (adjusted for inflationary increases less productivity)
2. The highest actual annual amount over the past five years (2015 to 2019)

A greater-of baseline test ensures that utilities only record amounts that are both:

1. In excess of what is already provided for in rates (adjusted for inflationary increases less productivity), and
2. In excess of what the utility has experienced in the past during non-pandemic years (i.e. evidence that the cost increase is beyond that of a typical fluctuation, supporting its attribution to the pandemic)

Likewise, when measuring discretely identifiable incremental savings to be recorded in the Account, OEB staff suggests that the baseline be established as the lower of:

1. The amount embedded in base rates (adjusted for inflationary increases less productivity)
2. The lowest actual annual amount over the past five years (2015 to 2019)

OEB staff has also considered the five-year average of historical actuals<sup>28</sup> instead of a five-year high/low.<sup>29</sup> OEB staff is receptive to stakeholder views on whether this baselining approach is appropriately reflecting causation to the pandemic, in a manner that is practical to administer.

OEB staff recommends that any emergency-related funding already included in a utility's revenue requirement should be factored into the calculation of incrementality. It should be a reasonable expectation that unutilized emergency-related funding is applied to any pandemic costs incurred, as an offset to amounts recorded in the Account. The recording of unutilized emergency-related funding in the Account may be done as a standalone entry, rather than apportioning those amounts as an offset to each discretely identified cost driver.

There may be some difficulties in identifying amounts included in base rates. These difficulties may arise in situations where there was either an OEB decision, or a settlement agreement between parties, that ordered a change to an OM&A envelope (for example), rather than to a specific amount that is part of that envelope. In these scenarios, OEB staff is of the view that utilities should identify these amounts in base rates on a best efforts basis.<sup>30</sup>

## **5.3 Net Cost-Sharing**

### **5.3.1 Recovery Rate of Eligible Amounts**

Subject to the means test explained further below, OEB staff proposes that 50% of incremental impacts should be eligible for recovery, for both utility operations impacts and customer-driven impacts.

The approach to cost sharing also acknowledges the OEB's responsibility to act as a proxy for competition. In the competitive business landscape, the pandemic has taken a devastating toll on a vast number of industries and businesses. Those businesses, by virtue of operating in a competitive arena, may not be able to transfer those losses to their customers. A recovery mechanism that fully insulates utilities from the financial

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<sup>28</sup> *Rationale for a five-year average:* The intent is to derive what a reasonable baseline would be in 2020 without the pandemic occurring. A prior five-year average mitigates anomalies in a singular year.

<sup>29</sup> *Rationale for a five-year high/low:* The utility has demonstrated that costs can reach that extreme in a non-pandemic scenario, and therefore, only amounts above (below) that measure should be deemed attributable to the pandemic with some degree of certainty.

<sup>30</sup> For example, a utility could apply the percentage reduction to the OM&A envelope approved by the OEB, or settled by parties, to the utility's requested amount in the same proceeding.

effect of the pandemic (irrespective of any means established) would be misaligned with the regulator's role to mirror the financial impacts utilities would face if they were not operating as monopolies.

For customer-driven impacts, this position is further supported by representing an appropriate balance between fully disallowing amounts on the basis that utility equity-risk premiums cover these impacts (as articulated in past OEB decisions), and 100% recovery, where the pandemic may be viewed as outside normal circumstances, the impacts of which are not assumed in an approved ROE.

OEB staff suggests an exception to the 50% recovery rate for the costs necessary to comply with government or OEB actions aimed at providing relief to ratepayers in response to the pandemic. These include:

- Implementation costs of emergency time-of-use (TOU) rates<sup>31</sup> and deferred global adjustment charges for electricity distributors<sup>32</sup>
- Implementation and administration costs of CEAP<sup>33</sup> and CEAP-SB<sup>34</sup>
- Increased LEAP EFA funding<sup>35</sup>
- Lost revenues from certain reduced/waived specific service charges<sup>36</sup>
- Incremental bad debt directly attributable to the extension of the winter disconnection ban

For these types of costs, OEB staff recommends full cost recoverability with a means test applied (but not the same means test as applicable to the rest of the Account). OEB staff's position is that the recovery of these amounts should be based on a means test whereby the utility's achieved ROE does not exceed the upper end of the dead band of 300 bps from a utility's approved ROE. OEB staff's view is that recoveries of these costs should not be subject to a test to demonstrate that financial viability is at risk without recovery. However, in the event that utilities exceed their approved ROE by more than

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<sup>31</sup> OEB's March 24, 2020 letter re: Immediate Changes to Time-of-Use Prices in Response to Coronavirus Emergency

<sup>32</sup> OEB's May 15, 2020 letter (Corrected on May 26, 2020) re: Guidance to Electricity Distributors on Implementing the Emergency Order Regarding the Deferral of a Portion of the Global Adjustment

<sup>33</sup> CEAP stands for COVID-19 Emergency Assistance Program; EB-2020-0162

<sup>34</sup> CEAP-SB stands for COVID-19 Emergency Assistance Program – Small Business; EB-2020-0185

<sup>35</sup> LEAP EFA stands for Low-Income Energy Assistance Program – Emergency Financial Assistance, as per the OEB's July 17, 2020 letter.

<sup>36</sup> These specific service charges include reconnection charges, late payment charges, non-sufficient funds charges, and notification charges not used for collection activities. See OEB letter, Guidance to Electricity and Natural Gas Distributors on Providing Relief to Customers During the COVID-19 Emergency, March 27, 2020.

300 bps, OEB staff does not find it appropriate to further compensate utilities for these amounts. This is consistent with the OEB's approach in assessing utility claims for incremental capital, as well as their inflationary rate increases. OEB staff also suggests that these amounts should, in aggregate, be subject to a materiality test independent of the rest of the amounts in the Account, as well as the typical causation and prudence requirements.

These incremental costs (or lost revenues) are directly attributable to the response from utilities to orders or recommendations from the Ontario government or the OEB to implement programs aimed at supporting customers with access and affordability to an essential service. Subject to the over earnings test set out above, OEB staff does not believe that utilities should be required to bear the financial impacts of those actions, irrespective of any demonstrated financial need or satisfaction of the necessity principle.

OEB staff also recommends that a utility may propose a case for recovery of greater than 50% for all other amounts, after passing the proposed means test. A case may be proposed, for example, in an instance of financial hardship or other extenuating circumstances that suggest financial viability may be at risk under a 50/50 cost-sharing arrangement. OEB staff recommends that the OEB should consider these types of requests on a case-by-case basis.

OEB staff also notes that this Staff Proposal refers to a recovery rate of 50%. For clarity, OEB staff is suggesting that the full incremental impacts (100%) be recorded in the Account, so that the OEB may appropriately undertake its prudence review, while 50% of those that are eligible are subsequently disposed of (with the other 50% being reversed from the Account).

### **5.3.2 Additional Considerations for Customer-Driven Impacts**

In the case of assessing recoveries for each of bad debt and lost revenues, OEB staff acknowledges that reasonable arguments could be made for both full recovery and no recovery. OEB staff's proposal for a 50% recovery rate represents a balance between these two positions.

With respect to the bad debt incurred by distributors, a large portion of this cost includes the flow-through commodity costs that distributors pass on to consumers without mark-up. OEB staff notes that in prior decisions where utilities have made specific requests for this aspect of bad debt, the OEB has opined that even though there is no explicit risk

premium associated with the commodity element of bad debt, the overall premium is sufficient to provide adequate compensation to the utility's shareholders.<sup>37</sup>

OEB staff notes that the OEB has in the past disallowed Z-factor treatment related to the lost revenue associated with a significant reduction in electricity consumption by a business customer, stating that "the Z-factor criteria were not intended to be used for the recovery of revenue losses".<sup>38</sup>

In another decision, the OEB indicated that the impact of a loss of revenue associated with load is an example of the realization of an aspect of business risk that the approved ROE is designed to compensate for. The OEB further noted in that decision that utilities are entitled the opportunity to earn a return to compensate it for the risks it incurs, and not a guarantee of it.<sup>39</sup>

The OEB has also previously referred to early rebasing as a potential solution for addressing lost revenue associated with lost load.<sup>40</sup>

OEB staff notes that the potential magnitude of bad debt and lost revenue associated with load impacts arising from this pandemic may be a differentiating factor from previous cases where these amounts have been denied. There could be arguments for full recovery given the unique (once-in-a-lifetime) nature of the pandemic. But there are also strong arguments supporting no recovery given the OEB's denials of lost revenue associated with load and bad debt claims in prior decisions.

With respect to the commodity portion of bad debt, OEB staff sees no compelling reason to differentiate those recoveries from the treatment of bad debt expenses in general. OEB staff takes the position that bad debt inclusion, and any potential recovery through the Account, should be viewed on a total cost basis and not split into different components.

With respect to certain lost revenues and bad debts incurred, namely by electricity and natural gas distributors, OEB staff acknowledges that these impacts have largely been incurred because utilities, as essential service providers, have effectively been

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<sup>37</sup> RP-2005-0020, EB-2005-0391, Milton Hydro Distribution Incorporated, Decision and Order, April 12, 2006, page 7; EB-2007-0881, Chatham-Kent Hydro Inc., Decision, March 17, 2008, page 5

<sup>38</sup> EB-2009-0332, Horizon Utilities Corporation, Decision, March 24, 2010, page 10

<sup>39</sup> EB-2004-0527, Oakville Hydro Electricity Distribution Inc., Amended Reasons for Decision, May 11 2005, page 3

<sup>40</sup> EB-2010-0131, Horizon Utilities Corporation, Decision on the Preliminary Issue of Early Rebasing and Procedural Order No. 4, December 15, 2010, pages 6-7

instructed to continue operations, irrespective of customer financial hardship, supporting the argument for recoverability. In the case of bad debt, and lost revenue associated with load, OEB staff supports the notion that on a case-by-case basis and in rare circumstances, early rebasing may be a more fitting solution than recoveries through the Account.

## **5.4 Application of a Means Test for Recoverability**

### **5.4.1 Basis for Means Test**

OEB staff proposes that a means test should apply to recoverability of the Account. The Account should operate to ensure utilities do not face undue financial hardship, as a consequence of, and for the period that the pandemic and government-issued restrictions to control the pandemic are in force. In OEB staff's view, utilities operating within the dead band are effectively managing within a reasonable degree of earnings fluctuation and therefore have maintained their opportunity for fair compensation.

As the Account was established to recognize the exceptional nature of the pandemic, OEB staff recommends that utilities should only be able to make use of this new mechanism if they demonstrate a need for it.

OEB staff believes that the basis for a means test is further supported by the findings in LEI's *Report on the OEB's Cost of Capital Parameters and the Impacts of COVID-19*. LEI has noted that "utilities cannot expect to both earn an equity return and have the financial consequences of risk eliminated" and that "there is little evidence to date that utilities have suffered consequences of COVID-19 for which they are not already being compensated".<sup>41</sup> OEB staff agrees with these perspectives, and is of the view that the equity risk premium built into a utility's approved ROE already provides the business with adequate compensation to withstand reasonable fluctuations in costs and revenues without the need for recoveries. OEB staff is of the view that it is only where extraordinary fluctuations exceed what a prudent utility could be expected to manage, or where the utility's financial viability is threatened, that ratepayers should be required to fund the disposition of the Account. The regulatory compact has never meant that the utility is entitled to be held harmless against all risks.

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<sup>41</sup> LEI, *A Report on the OEB's Cost of Capital Parameters and the Impacts of COVID-19*, December 15, 2020, page 10



#### **5.4.2 Earnings-based Means Test**

OEB staff's position is that the recovery of balances in the Account should be anchored to an ROE-based means test that is no greater than the lower end of the dead band of 300 bps from a utility's approved ROE. In OEB staff's view, the lower end of the dead band may be the most appropriate comparator for the OEB in determining at what point the utility's cost structure is substantially misaligned from its revenue stream.

OEB staff notes that the OEB applies the upper bound of this threshold to assess when a utility qualifies for incremental capital or an inflationary increase during an incentive rate-setting period. OEB staff proposes a similar approach, using the lower bound, when considering eligibility for recovery of the Account. In the case of the Account, OEB staff proposes that the ROE to be used as the threshold test is the actual performance in the year for which the impacts recorded in the Account are attributable to (e.g. for claims made for 2020 impacts, the test will be on the 2020 ROE results).

Stakeholders may wish to comment on whether recoveries should be limited so that the lower end of this threshold is not exceeded as a result of any amounts recovered, or whether there should be no cap for utilities that qualify for recovery based on their achieved earnings. OEB staff suggests that limiting any recoveries up to the lower end of the dead band is an important element to avoid the potential that utilities that under-earn end up in a better financial position, after having their claims approved, than those operating within the dead band, all else equal.

While OEB staff has set out a proposal for how an ROE-based means test can be applied, OEB staff invites stakeholder comments as to whether the lower boundary of the OEB's typical dead band is appropriate for the purposes of cost recovery eligibility.

OEB staff believes that ROE is the most appropriate metric to use in establishing a means test, as it is consistent with the approach utilized by the OEB in the application of other means tests. In cases where utilities pass the means test, but a net cost-sharing mechanism is expected to put their financial viability at risk, OEB staff is of the view that common financial ratios may be complementary and informative in assessing those exceptional circumstances.<sup>42</sup>

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<sup>42</sup> These include common liquidity and solvency measures such as the current ratio and interest coverage ratio.

## **5.5 Specific Sub-Accounts**

### **5.5.1 Overview of the Sub-Accounts**

To-date, the OEB has established the following sub-accounts, through various Accounting Orders:

1. Sub-account Costs Associated with Billing and System Changes
2. Sub-account Lost Revenues
3. Sub-account Other Costs
4. Sub-account Forgone Revenues from Postponing Rate Implementation
5. Sub-account Bad Debt

As part of this Staff Proposal, OEB staff has recommended that costs (or lost revenues) necessary to comply with government or OEB actions taken to assist ratepayers should be recoverable in full and that the applicable means test for recovery of those costs should be the upper end of the OEB dead band, rather than the lower end. OEB staff also notes that these costs have likely already been recorded in existing sub-accounts (for example, any waiving/lowering of certain service charges may have been recorded in the Lost Revenues sub-account and the bad debts directly attributable to the extension of the winter disconnection ban may have been recorded in the Bad Debt sub-account). Stakeholders are encouraged to indicate whether a discrete sub-account for these types of impacts, which OEB staff is proposing should have a separate recovery mechanism, would be helpful. Alternatively, the first sub-account “Costs Associated with Billing and System Changes”, which already holds the emergency TOU impacts, may be repurposed to hold all of the previously noted customer relief impacts.

OEB staff notes that any clearing of amounts in these sub-accounts will be subject to the OEB’s final rules and directions arising from the Consultation. An exception to this practice is the Forgone Revenues from Postponing Rate Implementation sub-account, which was removed from the scope of the Consultation, as that sub-account was subject to a mechanistic recovery process already processed by the OEB.<sup>43</sup>

The remaining three sub-accounts are discussed further below.

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<sup>43</sup> On August 6, 2020, the OEB issued an Accounting Order for the Establishment of a Sub-account to Record Impacts Arising from the COVID-19 Emergency for Forgone Revenues from Postponing Rate Implementation. This accounting order indicated that forgone revenues needed to be distinguished from other amounts recorded in the Lost Revenues sub-account, with these other amounts being subject to the consultation.

## 5.5.2 Revenue Impacts

OEB staff recommends that the impact of gains and losses from differences in load and production should be eligible for recovery, provided they are incremental and attributable to the pandemic. This approach may be perceived as a deviation from the approach taken historically by the OEB and the way other jurisdictions have generally approached recovery of lost load from the pandemic. However, in OEB staff's view, given the proposal for a means test, and the 50% recovery rate, it is appropriate to include all of the incremental, pandemic-related impacts as potentially eligible for recovery.

Furthermore, as described under the section 5.3.1 "Recovery Rate of Eligible Amounts", OEB staff also recommends that a utility may propose a case for recoveries of lost revenues at a rate of greater than 50%, after passing the proposed means test, in the case of financial hardship and other extenuating circumstances, with appropriate justification.

### *Criteria, Measurements, and Limitations*

In its report titled *A Report on Gains and Losses from Differences in Load and Production*, LEI developed a methodology to measure the incremental revenue impacts associated with the pandemic.<sup>44</sup> OEB staff supports LEI's approach to measuring and attributing these impacts to the pandemic. OEB staff views LEI's approach to establishing causality as generally consistent with its proposal for how to measure incremental costs under the section 5.2 "Measuring Incremental Impacts".

If the OEB decides to adopt a means test as proposed in this Staff Proposal, one aspect of LEI's approach may not be necessary. LEI's methodology suggests that after initially establishing an appropriate baseline for load, an important first step to take is an assessment of the difference between forecast and actual (not weather-normalized) load. This establishes "if the utility's actual load has deviated in some material fashion from the adjusted 2020 forecast, regardless of the cause (e.g. the impact of COVID-19, weather effects, or other effects)" before any pandemic-specific effects on load should be measured.<sup>45</sup> OEB staff believes that its proposed means test already confirms whether earnings remain within normally-expected boundaries, and that a similar test

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<sup>44</sup> LEI, *A Report on Gains and Losses from Differences in Load and Production*, December 15, 2020, page 1

<sup>45</sup> LEI, *A Report on Gains and Losses from Differences in Load and Production*, December 15, 2020, page 7 & 8

specific to revenue may not be required before proceeding to assess incremental impacts attributable to the pandemic.

### *Permanent versus Temporary Impacts*

#### *LEI's Report on Gains and Losses from Differences in Load and Production*

recommended that given uncertainties with the persistence and ongoing impacts of the pandemic, the approach to identifying impacts from differences in load attributable to the pandemic should not attempt to differentiate between load changes that may be temporary or permanent.<sup>46</sup> OEB staff agrees with this recommendation.

### *Responsibility, including any Rate Class Cross-Subsidization*

OEB staff recommends that utilities should be able to identify net load by customer class. The recovery of amounts associated with net load impacts should be from the customer class in which it occurred, unless it is not practical or reasonable to do so. In such a case, utilities should propose an alternative allocation methodology. When utilities record amounts in the Account, OEB staff suggests that these amounts should be recorded by customer class.

### *Treatment of Net Gains*

The pandemic is anticipated to have impacted the output of electricity generators. OPG is the only rate regulated generator in the province. OPG has acknowledged that its response measures to COVID-19 are expected to have an impact on its regulated ROE performance for 2020 and 2021, to the extent currently known or anticipated.<sup>47</sup> In addition, the single largest such impact relates to a planned deferral of a Darlington Unit 1 outage from the fall of 2020 to 2021 to support the revised start date of the Darlington Unit 3 refurbishment, which is anticipated to result in an increased ROE in 2020, with a corresponding decrease in 2021.<sup>48</sup>

Consistent with OEB staff's position on incremental cost savings, OEB staff suggests that any revenue gains attributable to the pandemic should be recorded in the Account

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<sup>46</sup> *Ibid.*, page 5

<sup>47</sup> EB-2020-0248, Ontario Power Generation Inc., Notice of Proceeding and Accounting Order, November 9, 2020, Schedule A, page 11 of 12. Schedule A includes a July 31, 2020 letter that OPG filed with the OEB regarding its Reporting and Record Keeping Requirements.

<sup>48</sup> *Ibid.* OPG indicated that while the change in the timing is expected to increase the 2020 ROE above the 300 basis points dead band, to 12.8%, it will have a corresponding negative effect on the 2021 ROE, which OPG expects to be slightly below the OEB approved ROE, at 9.0%.

as an offsetting amount. However, as discussed earlier, in OEB staff's view, the Account is not intended to result in net-credit dispositions to customers. Therefore, to the extent that any revenue gains attributable to the pandemic exceed the incremental costs, OEB staff submits that utilities should not be obliged to bring those amounts forward for disposition.

### **5.5.3 Other Costs and Savings (including Financing Amounts)**

The "Other Costs" sub-account was initially established for utilities to track the pandemic-related impacts aside from those that were to be included in the Costs Associated with Billing and System Changes or Lost Revenues sub-accounts (i.e. a catch-all sub-account for impacts not specifically identified). This section will address incremental financing costs (and savings), which have been captured in this sub-account.

OEB staff recommends that interest expense related to incremental borrowing costs, beyond calculated baseline levels, should be eligible for recovery. If additional financing was required to address short-term cash shortfalls, the onus should be on utilities to trace causality directly to the pandemic and not to either corporate debt/equity structure fluctuations or normal operating cash flow requirements. The discussion in the section 5.2 "Measuring Incremental Impacts" of this Staff Proposal should also be applied to the measurement of incremental financing amounts to be recorded in the Account.

OEB staff suggests that the incremental financing charges related to any pass through-costs should be eligible for inclusion in the Account. OEB staff's views regarding the bad debt amounts relating to pass-through costs are discussed under the section 5.5.4 "Bad Debt" of this Staff Proposal below. OEB staff notes that variances between revenues and costs that are captured in DVAs, including retail settlement variance accounts (RSVAs) for pass-through costs, attract the prescribed interest rate. OEB staff does not see a reason to depart from the prescribed interest rates for this Account, irrespective of whether impacts are attributable to typical revenue shortfalls, or in the case of bad debts, cash receipts.

OEB staff also is of the view that the benefits of lower interest rates, payment deferrals, or other gains to be made from strategic refinancing in the current economic landscape must be expected of utilities and should also be recorded in the Account to offset other

incremental costs that are recorded, in the event that a utility intends to make a claim for disposition of the Account.<sup>49</sup>

OEB staff's expectation is that utilities should adapt to the pandemic with strategic trade-offs resulting in cash inflows. Utilities should be expected to establish that incremental financing costs have been minimized and savings maximized, as a result of reprioritization of business activities.

OEB staff recommends that, provided the utility qualifies to file a claim and intends to do so, finance savings should be recorded in the Account, even if no incremental financing costs were incurred. If a utility realizes net finance cost savings, OEB staff recommends that this amount be tracked in the Other Costs sub-account, so that it can be considered in relation to all other amounts recorded in the Account.

#### **5.5.4 Bad Debt**

The OEB established a separate sub-account of the Account for bad debt, as per the Accounting Order issued on August 14, 2020. The OEB also noted that the Consultation would consider the methodology for determining the amount of bad debt that is to be recorded in the Account. The discussion in the section 5.2 "Measuring Incremental Impacts" should also be applied to the measurement of incremental bad debt amounts to be recorded in the Account.

The OEB's bad debt accounting order also referred to discrete bad debt which has arisen during the period of the pandemic, but due to reasons not relating to this pandemic. OEB staff recommends that such discrete bad debt should not be recorded in the Account and is not eligible for recovery.

"Pass-through amounts" are amounts that relate to certain commodity and other third-party charges. These are charges that distributors have paid or that are payable and that are intended to be passed through to their customers without earning a profit or incurring a loss.

As noted earlier, OEB staff recommends that any pass-through amounts themselves relating to bad debt should be eligible for recovery, subject to the same rules regarding

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<sup>49</sup> For example, the renegotiation of callable affiliate debt may occur in order to take advantage of low interest rates. Payment deferrals may include income tax, HST, property taxes, etc.

the means test and the 50% recovery rate.<sup>50</sup> OEB staff suggests that this treatment is appropriate because when bad debt amounts are approved in base rates as part of a rebasing proceeding, there are no distinctions made between the commodity and non-commodity portions of such bad debt.

#### **5.5.5 Potential Need for a Capital-Related Sub-account**

OEB staff considered the potential benefits of increased transparency in separately tracking incremental capital costs (and savings) attributable to the pandemic. OEB staff notes that capital expenditures, and their potential recoveries (or refunds) through the use of DVAs, requires a different approach with respect to how the revenue requirement impacts are calculated, in contrast to impacts on operating costs or revenues.

Capital expenditure increases or decreases may arise, should a utility initiate new capital projects not included in its distribution system plan (DSP) or capital plans, or cancel capital projects included in its DSP, as a result of the pandemic (i.e. directly attributable to the pandemic). Any permanent impacts may be eligible for recording in the Account. However, temporal shifts in the timing and execution of existing or planned capital projects should not be eligible. OEB staff is unaware of the extent to which permanent capital-related impacts attributable to the pandemic have affected utilities and whether these impacts would be material enough to warrant the establishment of a separate sub-account.

OEB staff suggests that any capital-related incremental impacts should be subject to the earnings-based means test and 50% cost-sharing mechanism underpinning this Staff Proposal.

With respect to establishing causation to the pandemic and measuring incrementality, it may be impractical to apply the proposed approach of comparing actual net capital expenditures against those approved or the prior five-year high, as explained in the section 5.2 “Measuring Incremental Impacts.” In OEB staff’s view, while it may be informative to the OEB to assess the overall capital expenditures in this manner (on an overall envelope basis), an individual project-level approach to incrementality may be more appropriate in certain circumstances.

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<sup>50</sup> As noted earlier, an exception to the application of the means test and the 50% recovery rate is incremental bad debt that is directly attributable to the extension of the winter disconnection ban.

OEB staff would welcome comments from stakeholders regarding whether, and why, they believe a separate sub-account for permanent capital-related revenue requirement impacts associated with the pandemic would be beneficial.

## **5.6 Other Considerations**

### **5.6.1 Period of the Account**

With respect to the Account (and associated sub-accounts), the Accounting Orders issued by the OEB in March, April and August 2020, indicated an effective date of March 24, 2020.<sup>51</sup> If a utility incurred material costs related to the pandemic prior to March 24, 2020, OEB staff suggests that it should record these costs in the Account, provided that they are separately identified, and the utility brings forward an argument for recovery when it seeks disposition.

OEB staff recommends that amounts should be recorded in the Account until the utility's subsequent rebasing application, assuming that the utility is able to support costs in future years (post-2020) as directly attributable to the pandemic. At the time of rebasing, utilities will have an opportunity to reflect their new operating "normal" provided that they can be reasonably expected to incorporate the effects of the pandemic into their forecasts.

### **5.6.2 Offsets – Cost Reductions from Government Assistance**

If a utility receives sources of funds, grants, or government assistance to assist with the financial impacts of the pandemic, OEB staff recommends that the amounts that qualify as not repayable should be credited to the Account. OEB staff notes that utilities are expected to consider and explain whether any repayable assistance programs, which may have favourable borrowing terms, should be reflected as finance cost savings and credited to the Account.

OEB staff notes that LEI described in its *COVID-19 Impact Study* both the government of Canada's and the government of Ontario's economic response plans to the pandemic, listing some government relief measures.<sup>52</sup> OEB staff recommends that

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<sup>51</sup> An exception is the OEB's August 6, 2020 Accounting Order for the Establishment of a Sub-account to Record Impacts Arising from the COVID-19 Emergency for Forgone Revenues from Postponing Rate Implementation. The effective date for this sub-account is the approved effective date of the new rates that are postponed for implementation due to the COVID-19 emergency.

<sup>52</sup> *COVID-19 Impact Study*, December 15, 2020, page 68-73



utilities applying for disposition of the Account should be required to provide detail regarding any government assistance.

### **5.6.3 Carrying Charges**

OEB staff suggests that carrying charges should apply to the Account, given that the impacts under consideration for recovery in the Account result in changes to a utility's cash flows. The carrying charge rate to be applied to the Account should continue to be derived using the long-standing prescribed interest rate methodology.

OEB staff is of the view that the prescribed interest rate methodology is also reasonable for the period during which the pandemic persists. In its August 14, 2020 issues list letter, the OEB determined that the appropriate carrying charge rate will be explored in this Consultation. While OEB staff sees no substantive reason to question the validity of this methodology at this time, it notes that the prescribed interest rate methodology may be due for a review, given that it was last explored in 2006.<sup>53</sup> However, OEB staff is of the view that if such a methodology review is conducted, this may be best carried out at a time when the economic effects of the pandemic have largely subsided. Furthermore, this review would not be completed before the conclusion of this Consultation.

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<sup>53</sup> EB-2006-0117, Approval of Accounting Interest Rates Methodology for Regulatory Accounts, November 28, 2006

## 6 Disposition Matters

### 6.1 General Disposition Considerations

#### 6.1.1 Timing and Process for Disposition Requests

OEB staff recommends that the Account should be treated as a Group 2 account, but unlike most Group 2 accounts, an application for disposition can be made outside of a rebasing application.<sup>54</sup> In OEB staff's view, it is preferable if a utility leverages a cost-based application for the review of the Account which requires a prudence review. In particular, the Account also relates very closely to impacts that would be reflected in a future cost of service review for a utility operating under its new "normal".

However, OEB staff also recognizes that, under the approach taken in this Staff Proposal, utilities that file recovery claims have already demonstrated a financial need by passing the means test. Therefore, OEB staff suggests that utilities should be able to file a stand-alone application once audited financial statements are available. OEB staff suggests that a stand-alone application may be filed, if utilities are of the view that waiting for a cost-based application is not a viable option, in terms of cash flow or other concerns.

OEB staff notes that the earliest opportunity for the Account balance to be brought forward for disposition will be in summer 2021, once the audited balance as at December 31, 2020 is available.

#### 6.1.2 Interim Disposition

OEB staff recommends that interim disposition of a partial amount of the Account balance should be considered on a case-by-case basis (e.g. if a utility is facing financial viability concerns). In the event a utility seeks interim disposition in the near term, any amounts recovered may be subject to a clawback, for example, in the event that the utility does not pass the means test.

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<sup>54</sup> EB-2008-0046, *Report of the Board on Electricity Distributors' Deferral and Variance Account Review Initiative*, July 31, 2009, page 6 states that Group 2 accounts include those that require a prudence review.

### **6.1.3 Audited Account Balance**

OEB staff is of the view that any interim disposition requests (which would be determined on a case-by-case basis) may be for either unaudited or audited Account balances. However, OEB staff recommends that final disposition requests should be for audited Account balances, following a utility's annual financial statement audit.

OEB staff notes that final disposition of audited account balances is consistent with the OEB's historical practice for other DVA dispositions.

## **6.2 Cost Allocation and Rate Design of Recovery Mechanism**

OEB staff recommends that utilities should propose any disposition based on accepted approaches to matters such as rate rider construction (including billing determinants, allocation methodologies and recovery periods), and bill mitigation. OEB staff recommends that appropriate rationale for any deviations proposed from that which have been previously approved for each utility should be provided. Where practicable, OEB staff suggests that utilities track incremental impacts based on their respective rate classes and rate zones, as applicable.